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Reviews - Writings in Accounting

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Reviews

Writings in Accounting

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"ACCOUNTING CHANGES AND STOCK PRICES," Robert Kaplan and Richard Roll, ***FINANCIAL ANALYSTS JOURNAL*****, Vol. XXIX, No. 1, January-February, 1973.**

Unconvinced by arguments that changes in accounting principles which increase earnings also support higher market prices for shares of stock, Professors Kaplan and Roll carried out some empirical research of accounting changes and stock prices. These theorists believe that when a company changes accounting principles, investors are aware and refuse to pay more for stock than "the firm's true economic condition" warrants.

The authors selected 275 firms that switched from productive-life to the flow-through method of amortizing investment credit and 57 companies which did not switch. They also surveyed 71 companies that changed from an accelerated depreciation method to straight-line. They classified those changes in market prices which were "due either to unspecified events or to earnings increases associated with the accounting changes" as abnormal.

As one might expect, the stocks of companies which had increased their earnings through changes in accounting principles experienced "abnormal" increases upon the initial earnings announcement. However, within 20 weeks after the accouncement these stocks began showing "abnormal" declines. In contrast, stock prices of firms that had not changed their accounting principles rose shortly after the announcement of earnings and continued to increase steadily throughout the observed period.

The authors attribute these changes in market prices to the publication of annual reports, which divulge the true nature of earnings. Their research supports the belief that "the existence of sophisticated investors should prevent a company from influencing its stock prices by manipulating accounting conventions."

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"ACCOUNTING: SOCIALLY RESPONSIBLE AND SOCIALLY RELEVANT," **Richard G. J. Vangermeersch, Harper & Row, New York, 1972; 363 pages, paperback, $6.95.**

Richard G. J. Vangermeersch, a University of Rhode Island Professor, has edited a collection of thirty-seven articles illustrating the exciting and changing nature of the accounting profession. The book, in paperback, has been organized into three parts.

Part I is titled "Accounting in Society and Organizations." The first article in this section, "The Scope of the Profession of Accountancy" by F. A. Cleveland dates back to 1905; however, it is not dated and is just as relevant today. The second article, reprinted from a 1906 Journal of Accountancy, asks the question, "What is the investor entitled to know?" Another selection is Sidney Davidson's "Accounting and Financial Reporting in the Seventies," which may become a classic. Part I deals with both internal and external reporting and includes articles on such other topics as budgeting, research and development, the SEC and accountants, and internal auditing.

The first selection from Part II entitled "Accounting Concepts" is an excerpt on "Concepts" from Paton & Littleton's masterpiece "An Introduction to Corporate Accounting Standards." Part II contains articles on the going concern assumption, the realization concept, price-level accounting (Maurice Moonitz) and conservatism (Robert R. Sterling).

Selections in Part III focus on financial accounting. Titled "Accounting Practices," it reveals what accountants are doing in the areas of depreciation disclosure, leasing, inventory pricing, earnings and financial statement interpretations — to name a few. These articles are written by such notables in the profession as John H. Myers, Arnold W. Johnson and Leopold A. Bernstein.

The articles are selected and grouped to show how the accounting profession is constantly responding to and adapting to meet social responsibilities. The book is excellent and interesting reading. The articles are from a variety of sources, including non-accounting journals. The table of contents is much too long to list, but the information given above should be enough to whet anybody's reading appetite.

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"ACCOUNTING RESEARCH AND ACCOUNTING PRINCIPLES", Robert L. Hagerman, Thomas F. Keller, and Russell J. Petson, ***THE JOURNAL OF ACCOUNTANCY*****, Vol. 135, No. 3, March 1973.**

The formation of the Financial Accounting Standards Board (FASB) presents an opportunity for new direction and new commitment in the profession of accountancy. The authors cite a need for new direction based on unsatisfactory results in the past. Formerly, emphasis has been directed toward narrowing the alternatives available to accountants, thereby increasing the comparability and uniformity of financial statements. The decrease in alternatives is assumed to increase the comparability (and therefore the usefulness) of investor's financial information. Since this emphasis is based on the false premise "that uniformity of method produces comparability of results", the time has come for new direction and new emphasis.

The authors examined two methods of empirical research to support their argument: the laboratory method and the market-oriented method. The laboratory method supports the conclusion that the investor (or user of financial statements) is often unable to reconcile the difference in accounting treatment for the same economic event. Since the only information available to the laboratory subject is the financial statement, the environment becomes *too* controlled. Therein lies the weakness of this method. In market-oriented studies, however, subjects received exposure to other, alternative sources of information (i.e., analysts, financial news, etc.) concerning the companies under consideration. After a short time lag, investors in this group were able to compensate for varying methods of accounting for economic events, evidenced by activity on the stock markets. This group, though *less controlled*, more closely approximated the real world. By examination and comparison of these two methods of research, the authors supported use of the market-oriented method by the FASB in its formulation of the principles of accounting.

In their opinion the FASB should focus on the usability of information (supporting the market-oriented method) rather than the application of some "best" accounting principle which imposes an artificial uniformity on a non-uniform environment. Disclosure becomes particularly important in the application of the market-oriented method. Any unique aspects of a particular transaction should be disclosed along with the underlying accounting principles which govern the treatment of the transaction.

In summary, the authors present a valid argument for a new direction supported by analysis of past research.

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